Supreme Court, U.S.

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No. _____

In The

Supreme Court of the United States

October Term, 1997

RUSSELL WEINSTEIN,

Petitioner,

v.

FIDELITY BROKERAGE SERVICES, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITION FOR WRIT OF CERTIORARI

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43 pp

QUESTION PRESENTED

Russell Weinstein lost close to $500,000 through an investment advisor trading speculative options at Fidelity Brokerage Services, where Mr. Weinstein's investment objective was recorded as "Capital Appreciation." Fidelity's options supervisor did nothing to halt the trading and was not even aware that an Options Supervisory Procedures manual existed. The New York Stock Exchange arbitration panel found negligence and awarded $100 (about 2/100ths of 1% of the losses). The lower courts confirmed the damage award. The question is:

> **Can such an award stand if judicial review under a "manifest disregard" standard is to be genuinely meaningful, as suggested in the decisions of this Court?**

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PETITION FOR WRIT OF CERTIORARI

Russell Weinstein respectfully petitions for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the First Circuit entered in this proceeding March 16, 1998.

OPINION BELOW

The opinion giving rise to this Petition is unpublished. It is reprinted in the Appendix hereto at pages App. 1 *et seq.*[1]

JURISDICTION

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254. This Petition has been filed within 90 days from rendition of the lower court's opinion. This Petition seeks review of an important question of federal arbitration law that has not been decided by this Court. The opinion of the lower court also may conflict with a decision by the Court of Appeals for the Eleventh Circuit.

[1] Though not published by Westlaw in Federal 3d, the opinion will be available through such secondary sources as the Securities Arbitration Commentator and CCH Federal Securities Law Reports. In the field of retail securities, little remains secret.

STATEMENT OF THE CASE

This New York Stock Exchange arbitration was tried in Clearwater, Florida December 4-6, 1996. The arbitration complaint pled four legal theories for recovery of damages:

1. Florida Securities Investor and Protection Act.
2. Breach of contract.
3. Breach of fiduciary duty.
4. Negligence. RX1[2]

The award was served upon the parties December 24, 1996. The operative part of the award simply stated:

> "DECISION: The undersigned arbitrators have decided and determined in full and final settlement of all claims between the parties that: Judgment in favor of Claimant on negligence claim in the amount of $100.00. The remainder of Claimant's claims are dismissed."

At the arbitration, counsel for Claimant called three witnesses: Kurt Muller, Director of the Fidelity Investment Advisory Group's options trading desk; Petitioner

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[2] References are to the Record on Appeal before the United States Court of Appeals for the First Circuit. The Record there consisted of the following: the entire pleading file from the District Court, cited as R-(and the pleading identified or referred to), and the Arbitration Record as filed with the District Court. The Arbitration Transcripts will be cited as RT-(and page number(s)); the Arbitration Exhibits as, *e.g.*, RX4-3 (Exhibit 4, page 3); and the legal authorities and memoranda furnished the arbitrators, as RL-(with the memorandum or decision identified).

Russell Weinstein, and John Lyman who testified as to the range of damages, *viz.* $495,000 to $812,000. Fidelity's counsel did not question Mr. Muller during Claimant's case in chief, but did cross-examine Mr. Weinstein and John Lyman. Fidelity rested without calling any witnesses.

Mr. Weinstein opened an account at Fidelity through investment advisor Eduardo Lluria of Classic Asset Management, Inc. Petitioner's IRA rollover account began with about $500,000 accumulated through the years from his dental practice. The Fidelity account applications for Russell Weinstein's IRA showed he had no prior experience with options trading. RX4-3, RT-69-70. These forms all showed an investment objective of "Capital Appreciation." RX3-1; RX4-2; RT-66, 68-69. Not checked as an investment objective was "Speculation." RX4-2. (For a clear, readable copy of the Fidelity Options Account Application, see the facsimile at RX4-7 *et seq.*) The investment objective boxes available were: Preservation of Capital, Income, Capital Appreciation, Speculation, Trading Profits and Undecided. The account ran – with one interruption – from October 1992 until September 1994, when it was substantially depleted by the purchase and sale of put and call options during the preceding few months. RX16-3-8.

Fidelity's arbitration answer did not deny the unsuitability of the trading in foreign mutual funds and options. In fact, Fidelity filed a third-party arbitration claim against Classic and Lluria contending they were "liable to Claimant for any unsuitable transactions . . . " RX2-5. The actual trading activity in the account was

wholly speculative. When asked what "Capital Appreciation" meant in Fidelity's scheme as an investment objective, Mr. Muller said, "Capital appreciation to myself is maintaining an investment return on your money." RT-66. Later he explained the difference between capital appreciation and speculation as used on Fidelity's forms: "Capital appreciation is investment income and maintaining principal. And speculation would be just what it is, speculation, risky." RT-70. Mr. Muller acknowledged that concentrating $236,000 in put options in one month in an IRA account was not consistent with an investment objective of Capital Appreciation. "Yeah, that would be speculative." RT-94.

Fidelity had in place all the internal rules and regulations required of broker-dealers by the exchanges. The IRA customer agreement recited that "All transactions through FIBSI are subject to the constitution, rules, regulations . . . of the exchange . . . where executed, as well as any applicable federal or state laws, rules and regulations." RX3-5. Fidelity's "Supervisory Procedures and Compliance Manual 1993" reflects the high principles required by SROs of all broker-dealers:

> "FIBSI endeavors at all times to operate in conformity with federal and state laws. . . . We believe that we can best serve our clients and customers . . . when all of our personnel are informed as to the legal, technical and mechanical aspects of our business *and have a good working knowledge of practices suited to achieve customer objectives and comply with the law.*" RX19-2. (Emphasis added.)

This manual goes on to state that FIBSI is responsible for "ensuring your familiarity with statutes, rules and by-laws governing your registrations . . . " Therefore, Fidelity management

> "expect you to be thoroughly familiar with our procedures and policies as set forth in this Manual. Appropriate disciplinary action will be taken for deviance from these procedures." RX19-2.

Fidelity also had a detailed **Options Supervisory Procedures Manual**. It had not been produced in discovery prior to the hearing. Its existence was noted because the last sentence in the Supervisory Procedures and Compliance Manual for 1993 states, "The Options Supervisory Procedures Manual should be referred to for additional information." See RX19-17. When asked if he could explain what that manual was (the day before it was flown in and produced), Mr. Muller said, **"I am not aware of the options supervisory procedures manual."** RT-45. Mr. Muller was the officer charged with supervising the options trading for advised accounts.

Obviously a shorter set of antenna are utilized when supervising advised accounts. Fidelity's Options Supervisory Procedures Manual also states the obvious. Since the firm does not permit options recommendations, it is

> "not required to perform the level of supervision normally required of a full-service broker/dealer. There are, however, certain aspects of its options business which follow and require supervisory oversight." At RX24-8.

The trigger for this review of advised accounts is found under the heading, "Review of Trading Activity":

> "In the event such ROPs [Registered Options Principals] note *unusual options activity* they should promptly notify the FMR Corp. Compliance Department." RX24-9. (Emphasis added.)

Throughout presentation of Claimant's case, Fidelity's legal position was simply that since it did not make recommendations, it *could not* be liable for the action of an investment advisor no matter the extent of the "unusual options activity"; therefore, its Compliance Manual and Options Supervisory Procedures Manual could be of no help to Mr. Weinstein. This position was held steadfastly during Mr. Muller's testimony. He stated that "When an options account is opened, it is reviewed by a Series 8 [compliance officer] and he signs off on it if options can be traded in that account." RT-38. (An investment objective of capital appreciation could contemplate only covered call writing, that is, selling call options stock owned and held in the account; the *purchase* of puts and calls can only be described as speculative.) When asked if signing off on a new options account was the "end of the firm's supervisory review for suitability," Mr. Muller answered, "Yes, it is." RT-38.

Mr. Muller was also in charge of the options compliance officer. Mr. Muller thought that person's duty was simply "To ensure that the trades are taken accurately and that the executions are reported back to the clients." RT-42. But did the compliance officer have any responsibility to determine suitability of a particular trade? That is, whether the trade or trading was suitable for an investment objective of capital appreciation. Mr. Muller answered, "No, he does not." RT-42. He acknowledged

that he knew of no procedure for monitoring the frequency of transactions, *viz. a viz.* any particular customer:

> "A. Not that I am aware of.
>
> Q. How about the size of the transaction?
>
> A. Not that I am aware of. . . . Quantity has nothing to – quantity doesn't come into play." RT-43-44.

In short, once the account was opened – according to Mr. Muller – Fidelity's own rules and regulations had no relevance, and Fidelity apparently was immune from a broker-dealer's duty under SEC and exchange rules pertaining to suitability and supervision. Yet Mr. Muller and his co-workers did meet and discuss the problem raised by Eduardo Lluria's option trading (not only with respect to Mr. Weinstein but approximately twenty other advised clients). However, "[T]here was not any conversation of contacting Mr. Weinstein." RT-247. And according to Mr. Muller, Fidelity made no changes in its procedures as result of the Eduardo Lluria matter: "Not that I'm aware of, at least within my division, trading." RT-118, 119.

Counsel for Fidelity moved for dismissal and each side presented the arbitrators with authorities pertaining to broker-dealers and their duties *vel non* with respect to advised accounts. Claimant's Memorandum of Law given to the arbitrators had attached four authorities on this subject: *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F. 2d 38 (2d Cir. 1978) RL-Tab A; *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528 (D.MD 1978) RL-Tab B; *Ruiz v. Charles Schwab & Co.*, 736 F. Supp. 461 (S.D.N.Y. 1990), RL-Tab C; *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, SEC Release No. 19070, 1982, CCH

¶ 83,258, RL-Tab D. For its part, counsel for Fidelity delivered to the arbitrators a memorandum and copy of *Chee v. Marine Midland Bank*, CCH Fed. Sec. L. Rep. ¶ 95,806 (E.D.N.Y. Jan. 21, 1991). RL-Tab D, 4-11.

The arbitrators concluded on the basis of the evidence and authorities that Fidelity was liable, but only on the negligence claim. At the district court, petitioner sought confirmation of the negligence claim and vacation of the award of only $100 in damages and vacation of the denial of liability and entry of judgment under the Florida securities claim. Respondent Fidelity successfully sought confirmation of the entire award. In the court below Petitioner unsuccessfully claimed that the arbitrators disregarded the law and evidence by awarding only $100 in damages. The Court of Appeals held that while "procedures in arbitration are informal . . . arbitrators . . . are expected . . . to decide the case in accordance with the applicable law." App. 3. The lower court appeared to acknowledge that a showing of manifest disregard of either the governing law or the facts could lead to vacation, but observed that such a showing is "extremely difficult" where, as here, there is no explanatory opinion by the arbitrators. App. 4. Apparently putting itself in the shoes of the arbitrators, the court concluded that "Weinstein's challenge to the comparative negligence allocation easily fails."

> "The judgment that Weinstein and his own self-selected advisor were almost entirely responsible for the loss does not seem to us to be patently mistaken, let alone a deliberate disregard of any settled rule of law or established facts." A-5.

REASONS FOR GRANTING THE WRIT

The Proper Standard of Review of Arbitration Awards Presents an Important Question of Federal Law that Ought to be Decided by this Court. The Judicial Gloss on the Federal Arbitration Act Should Contemplate a Necessarily Narrow Review of Arbitration Awards, But One with Criteria-Based Scrutiny to Insure Participants an Expectancy Roughly Comparable to Judicial Results; to the Extent the Decision of the Court Below Reflects the Prevailing View, it is Clear that Judicial Review Under a "Manifest Disregard" Standard Exists in Name Only.

It is assumed there will continue to be judicial review of arbitration awards. The most frequently utilized label is "manifest disregard of the law." The standard of review should be the same whether the award resolved issues under federal securities statutes or a myriad of other statutes and common law causes of action. The sheer number of decisions acknowledging the "manifest disregard" standard, and the importance of maintaining a healthy arbitration system, supports two observations: first, this Court most likely will not eschew judicial review; second, it would seem time for this Court to articulate policy-based guidelines that will lead to more effective, albeit limited, judicial review.

It would be difficult to imagine a more appropriate case than the one at bar for a first explication of proper criteria, for both review of the law and of the facts. Obviously the Federal Arbitration Act does not require judicial review under any standard, other than for the reasons set forth in § 10. There are sound policy reasons

for articulating a better standard than the present "manifest disregard." Much ink has been devoted in judicial and legal commentaries to drawing the boundaries of this standard. It seems every court states the test somewhat differently. But one thing does not change:

> "Although the 'manifest disregard' standard is an additional ground in federal court to vacate an award, its application has been so limited that one stands a snow ball's chance in hell at succeeding." D.Robbins, *Securities Arbitration Procedures Manual* (3d ed. Lexis Law Pub.) at 626.

In the field of federal securities, Congress' special concern for investor rights led to *Wilko v. Swan*, 346 U.S. 427 (1953); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); and *Rodriguez v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). *McMahon* of course is a watershed case for arbitration because of the very real control of the arbitration process by the securities industry tempered only by the distant oversight of the SEC. The concerns discussed by Justice Blackmun in his separate opinion, concurring and dissenting in part, 482 U.S. 242, 259 *et seq.*, certainly have been borne out in the decade since *McMahon*.

There can be do doubt that in the past decade arbitration and mediation has gained great momentum. The use of alternative dispute resolution techniques helps both to keep litigation out of court and to resolve much of what goes to court. But if this arbitration system is to maintain the confidence of both business and the public, judicial review ought to be meaningful, though necessarily rather

narrow. This is particularly true in retail securities arbitration, for here the scales are tilted so decidedly in favor of the industry. This is in sharp contrast to, say, construction arbitration. SRO arbitration rules require one industry representative on each three-person panel. The Commercial Rules of the American Arbitration Association do not require a "general contractor" member on each panel, nor an "architect" member or the like.

Counsel estimates that a very high percentage of all challenges to securities arbitration awards are brought by disappointed investors. (But still, only a minute percentage of awards adverse to investors are ever challenged.) Certainly the challenges that are made are not always authored by inexperienced counsel. But it is respectfully submitted that under the present standard, however formulated, an investor can almost never successfully challenge an unjust award.

Fidelity's liability on the negligence claim in the case at bar certainly is supported by the overwhelming weight of the evidence. But an award of $100 – no more than 2/100th of 1% of the $500,000 in losses – simply emphasizes the present need for a meaningful standard of review.

One test that seemed to hold logical promise was that set out in *Advest, Inc.v. McCarthy*, 914 F. 2d 6, 8-9 (1st Cir. 1990).

> "In the main, a successful challenge to an arbitration award, apart from section 10, depends upon the challenger's ability to show that the award is '(1) unfounded in reason and fact; (2) *based on reasoning so palpably faulty that no judge, or group of judges, ever could conceivably have made*

> *such a ruling*; or (3) mistakenly based on a crucial assumption that is concededly a non-fact.' " (Emphasis added.)

Since we are supposed to be a nation of laws not men, the "group of judges" component makes the best starting point for the test: for the objective is to utilize lay arbitrators to a great extent without at the same time judicially acknowledging general acceptance of bizarre, mean-spirited awards, or any award "unfounded in reason and fact." Any judicial acceptance of such awards is inimical both to arbitration as a system and to what individual parties expect when subjected to what is often compulsory arbitration. The "reasonable arbitrator" presumably would have first to be endowed with a minimum level of legal and ethical understanding of the problem. Query, how could any judge or "group of judges" articulate a decision to award 2/100th of 1% of this investor's damages when 1) the options supervisor did not even know of the existence, let alone the contents, of his own firm's Options Supervisory Procedures manual, and 2) the supervisor clearly *did not* understand the supervisory purpose of recording investment objectives, when on the other hand that supervisor *did* know the options trading activity was speculative and wholly inconsistent with Fidelity's recorded investment objective of "Capital Appreciation."?

But it seems the court below did not use this *Advest* test, which perhaps should be labeled the "enlightened judges test." The court instead seems to have employed a test that looks at any possible view of the evidence that an arbitrator could possibly take. The court said an arbitrator could conclude that Mr. Weinstein was responsible

for 99.998% of the loss: this view "does not seem to us to be patently mistaken, let alone a deliberate disregard of any settled rule of law or established facts." App. 5. Admittedly, a lay arbitrator might see the logic in this view. But judges understand the law to be that a good faith damage award must follow a determination of liability, no matter that judge's view of the plaintiff, his wisdom or his folly. Could any judge assess .002% of the proximate cause of the loss against an SRO regulated broker-dealer and 99.998% against the investor whose only wrong was not knowledgeably supervising his advisor and the regulated broker-dealer? This line of inquiry, simple as it is, illustrates petitioner's contention that the "manifest disregard" test is illusory.

Arbitration award review must be narrower than the search for legal error in the traditional appellate process. Certainly the actual formulation of a "manifest disregard" standard of review will no doubt be drafted with the overarching limitation that a court will set aside an arbitrator's decision "only in very unusual circumstances." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995). Nevertheless, such review should not be wholly illusory as it came to pass in the case at bar. In the retail securities arena, awards carry no explanation of the arbitrator's rationale. (Case summaries in NASD awards are prepared by staff counsel and increasingly by counsel for the parties; as such, these summaries offer no insight into the collective mind of the arbitrators.) Thus, no relief appears possible if one element of the review test is a requirement to clearly and convincingly show "from the record that the arbitrator recognized the applicable law – and then ignored it." *Advest, supra* at 9. Few advocates

can offer more than circumstantial evidence from the record that the arbitrators knew *and* decided to ignore the applicable law. Yet it seems clear that circumstantial evidence from the record will not suffice.

One straightforward critical analysis of "manifest disregard" is K. Davis, *When Ignorance of the Law is No Excuse: Judicial Review of Arbitration Awards*, 45 Buff. L. Rev. 49, 88-101 (1997) ("Davis, Judicial Review"). Apparently all circuits but the Fifth have now accepted some form of the manifest disregard standard. *Id.* at 97. (The standard was recently applied in *Montes v. Shearson Lehman Brothers, Inc.*, 128 F. 3d 1456 (11th Cir. 1997).) But as long as the arbitrator must be caught saying on the record that he plans to ignore the law, the test seems illusory.

> "Manifest disregard, as defined in [*Merrill Lynch, Pierce, Fenner & Smith v.*] *Bobker* [808 F. 2d 930 (2d Cir. 1986)] and most circuit court decisions, is nearly impossible to prove because, even in the rare case where an arbitrator deliberately ignores controlling law, the arbitrator will not announce his misconduct. He will exercise the prerogative not to explain the award. Short of hiring a soothsayer, the court will have no means of divining whether the arbitrator erred intentionally." Davis, Judicial Review at 94.

In the case at bar, Fidelity – whose Mr. Muller literally knew nothing about effective supervision in accordance with his firm's SRO required manuals – was assessed a share of negligence of about 2/100ths of 1%. An initial standard of review for the present case might well start with application of the criteria suggested by Professor Davis:

> "As a means of correcting error, the standard might reasonably consider the magnitude, quality and consequence of the error under review, rather than the arbitrator's state of mind, a matter of irrelevance." Davis, Judicial Review at 99.

For a brief enlargement on the criteria of the *magnitude* of the arbitrator's error, the *quality* of the error and the *consequence* of the error, see *id.* at 98-101, App. 7-9.

This is a federal question that calls for an answer by this Court. Although any decision in the case at bar will engender innumerable analyses by lower courts, a set of policy-based criteria will instantly contribute to a meaningful albeit narrowly prescribed standard of review. Such a standard must have relevance to a judge's perception of the legal and factual wrong involved. It simply is wrong-headed – if the objective is a laudable system – to have review turn on the undisclosed state of mind of an untrained arbitrator. Such a subjective test gives full protection to arbitrators who see no illogic in punishing the investor victim, such as Mr. Weinstein, whom arbitrator Senesac saw as wanting "to get rich" (RT-160) and therefore deserving to lose a lifetime of IRA savings. From the investor's standpoint, the truly amazing thing is that not one circuit has developed a more objective set of criteria for reviewing meritorious challenges to awards such as the one in the case at bar. It would seem time for this Court to reject the circuit courts' standard of review and articulate one that enhances public confidence in arbitration.

The lower court's analysis contrasts and seemingly conflicts with that in *Montes v. Shearson Lehman Brothers, Inc.*, 128 F. 3d 1456 (11th Cir. 1997). Ms. Montes sought

overtime pay from Shearson under the Fair Labor Standards Act. Shearson claimed she was an exempt employee, but had only weak evidence to support that defense. Arbitration counsel for Shearson apparently recognized the factual weakness of the defense and, basically, urged the arbitrators not to follow the law. *Id.* at 1459. That rather arrogant position seems to be what triggered the court to weigh the evidence anew. The facts overwhelming favored Ms. Montes. But it apparently took these two factors to lead the court to remand for a new arbitration: 1) counsel's open call to disregard the law and 2) the absence in the award of any indication "that the arbitrators rejected Shearson's plea to manifestly disregard the law." *Id.* at 1464.

But query, if it seemed clear the arbitrators did not follow the Fair Labor Standards Act law, what was gained by constructing this syllogism and concluding that, 'Yes, the arbitrators decided to *disregard* the law'? Perhaps *Weinstein* and *Montes* do not represent a clear conflict in the circuits of the proper application of the manifest disregard standard. Perhaps the call to disregard the law in *Montes* will never be repeated, at least not quite so overtly. But counsel often disagree on the applicable law, even when the greater weight of reasoned authority – as in the case at bar – can hardly be considered in doubt. If there were a narrow but meaningful standard of review, could the awards in *Montes* and the case at bar stand? It would seem not.

In the retail securities field there is an acute danger if arbitration awards are so completely shielded by the present manifest disregard standard. The danger comes from quasi-professional arbitrators, who are appointed

often enough to develop a jaundiced view of securities violations (which view many believe facilitates reappointment). For example, in the case at bar a factual question arose as to why the account fluctuated so dramatically in the three months before all the money was lost. One of the public arbitrators apparently did not understand the volatility and danger of trading large positions in puts and calls. Logically, Mr. Senesac, the industry member of the panel, would see the danger to the advisor's clients being exposed to such rank speculation, and particularly the danger to Mr. Weinstein whose IRA account had an investment objective that did not even contemplate speculation. But Mr. Senesac simply observed, "They want to get rich." RT-160. Perhaps this was the view of only one arbitrator. But it is the view of one arbitrator with confidence in his power to impose what appears to be a reprehensible, private view of the facts and law, with virtually no fear of later being called to task by the courts. This is the real danger if review is essentially meaningless, for arbitrators like Mr. Senesac well know how far they can go in arguing their private view of justice to the panel.

It is respectfully submitted that this Court ought to begin the process of articulating a meaningful, policy-based standard of judicial review of arbitration awards rendered under the FAA. There certainly is no uniformity among the courts, nor among the commentators. See, *e.g.*, S. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 Ga. L. Rev. 731 (1996), and M. O'Mullan, *Seeking Consistency in Judicial Review of Securities Arbitration: An Analysis of the*

Manifest Disregard of the Law Standard, 64 Ford. L. Rev. 1121 (1995).

In the case at bar, the arbitrators found for Mr. Weinstein on the basis of his negligence claim. This is not surprising, given the legal authorities argued and presented to the panel and the overwhelming weight of the evidence showing a total lack of knowledge by Fidelity's employee of the rudiments and purposes of supervision. (For a greatly condensed summary of the testimony see App. at 10-20.) If Mr. Weinstein's investment objective had been speculation, we might have only a difference in degree in comparing his passive negligence with Fidelity's passive negligence. But that is not quite the case. Mr. Weinstein's investment objective was clearly noted as capital appreciation, an objective totally inconsistent with speculating in options. New York Stock Exchange Rules 342 and 401 – argued and furnished to the arbitrators, RL-Tab 2 – require written supervisory procedures of all broker-dealers and require that each firm "Supervise diligently all accounts handled by registered representatives of the organization." Surely no group of judges could argue that the civil penalty for abject failure to follow these supervisory mandates can be limited to $100. Indeed, the same rationale that denied Mr. Weinstein's appeal in the court below would also support denial of an award of $1,000, $90, $10, $1 or even 1¢. Violation of these obligatory SRO rules should certainly come with a higher price tag.

To date, the courts have devoted countless pages articulating the manifest disregard standard, for it is both interesting and critically important to public confidence in what is often compulsory arbitration. But these same

courts almost never apply their tests so as to order a new arbitration for investors. Petitioner respectfully submits that a narrow but meaningful and effective formulation of the "manifest disregard" standard can and should be undertaken by this Court.

CONCLUSION

It is respectfully submitted that this petition should be granted so this Court can decide the advisability of articulating a meaningful standard of review. Such a standard can and will build confidence in the arbitration system without at the same time encouraging non-meritorious challenges.

Respectfully submitted,

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[NOT FOR PUBLICATION]

UNITED STATES COURT OF APPEALS
For the First Circuit

No. 97-2173

RUSSELL WEINSTEIN,

Plaintiff, Appellant,

v.

FIDELITY BROKERAGE SERVICES, INC.,

Defendant, Appellee.

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF MASSACHUSETTS

[Hon. Edward F. Harrington, *U.S. District Judge*]

Before

Boudin, *Circuit Judge*,

Aldrich and Cyr, *Senior Circuit Judges*.

Robert Dyer with whom *Allen, Dyer, Doppelt, Milbrath & Gilchrist, P.A.* was on brief for appellant.

Michael K. Wolensky with whom *Angela G. Miele, Kutak Rock, David C. Boch* and *Bingham, Dana & Gould LLP* were on brief for appellee.

March 16, 1998

Per Curiam. Dr. Russell Weinstein lost approximately $500,000 through speculative investments in foreign mutual funds and options made through Fidelity Brokerage Services, Inc. ("Fidelity"). Under the brokerage agreement, an arbitration panel considered Weinstein's claims against Fidelity alleging negligence, breach of contract and fiduciary duty, and violation of Florida Blue-sky laws. Dissatisfied with his award, Weinstein brought the matter to federal court.

The background facts are essentially undisputed. In 1991, Weinstein retained as his investment advisor Classic Asset Management, Inc. ("Classic") and its principal, Eduardo Lluria. September of 1992, Weinstein moved his brokerage account to Fidelity, empowering Classic to make the investment decisions for his account. Thereafter, between September 1992 and August 1994, Classic's trading on Weinstein's behalf produced the significant losses of which Weinstein now complains.

In the arbitration proceeding, a panel of three arbitrators appointed by the New York Stock Exchange heard testimony, reviewed exhibits, and heard arguments of counsel during four days of hearings in December 1996. On December 6, 1996, the arbitrators issued a decision, holding Fidelity liable for negligence, awarding Weinstein $100 in damages, and dismissing the remaining claims. The panel did not write an opinion.

Weinstein then sued in district court to confirm the portion of the award finding Fidelity liable but to vacate the panel's refusal to award more than $100 or find against Fidelity on other grounds, Fidelity filed a motion to confirm the entire award. In a summary order, the

district court granted Fidelity's motion, and Weinstein now appeals. Fidelity says Weinstein's court challenge was untimely, but it appears that this is simply a dispute about how he captioned his challenge.

As a legal basis for his challenge to the arbitration award, Weinstein's complaint invoked the Federal Arbitration Act, 9 U.S.C. §§ 1-16, and neither side questions the applicability of the statute. Section 10 sets forth a limited number of grounds on which an arbitration award may be vacated, including fraud, partiality or corruption, misbehavior by the arbitrators or action "exceeding their powers." 9 U.S.C § 10. Although Weinstein charged "evident partiality" in his complaint, this claim has not been preserved on appeal, and we focus instead on his challenge to the merits of the award.

The procedures in arbitration are informal, but arbitrators resolving contract claims are expected to respect the terms of a contract and to decide the case in accordance with the applicable law. But one of the characteristics of arbitration is that any judicial review of the arbitrator's decision on the merits is very limited and primarily confined to misconduct or excess of authority. The result is a speedier and less expensive process.

Although section 10 does not explicitly provide for *any* review on the merits, courts nevertheless gloss the statute to permit very limited review of the merits in unusual circumstances. The pertinent case law and rubrics, not all entirely consistent, are described in *Advest, Inc., v. McCarthy*, 914 F.2d 6 (1st Cir. 1990). Without touching on all of the nuances, it is enough to say here that in order to prevail, Weinstein would have to

show a deliberate decision by the arbitrators to ignore the governing law; mere mistakes are not a basis for review. *Id.* at 10.

As arbitrators are not normally required to explain their decisions, and the panel did not do so here, showing a disregard of the governing law or facts is extremely difficult. In this instance, Weinstein's main claim is that, having found negligence on the part of Fidelity, only a deliberate refusal to follow the law could justify an award as small as $100. Weinstein points out that he lost approximately half a million dollars through the trades in question of which $100 is a minute fraction.

Starting with the negligence charge, the parties dispute whether the negligence claim is governed by the law of Florida, where Weinstein resides, or Massachusetts, where Fidelity is located. But both jurisdictions follow the doctrine of comparative negligence. *See* Fla. Stat. Ann. § 768.81; Mass. Gen. Laws ch. 231, § 85. Even leaving aside Massachusetts's [sic] preclusion of any recovery for a plaintiff who is more than 50 percent responsible, we see ~~no~~ deliberate disregard of the law in a determination that Weinstein himself was so overwhelmingly responsible for the loss that any oversight by Fidelity was adequately reflected in the most nominal $100 award.

The key point is that Weinstein selected his own investment advisor and gave Classic the authority to make the trading decisions that produces the loss. Weinstein received reports from which he could have monitored the trading and the resulting losses. Fidelity's negligence, on Weinstein's own theory, was its passive failure to discern the pattern of inappropriate or risky

trading and to draw Weinstein's attention to the pattern, even though the recommendations for the trades were not provided by Fidelity.

The judgment that Weinstein and his own self-selected investment advisor were almost entirely responsible for the loss does not seem to us to be patently mistaken, let alone a deliberate disregard of any settled rule of law or established facts. Fidelity's alternative explanation for the $100 award – that Fidelity was sanctioned for its delay in producing documents – seems to us less likely, but we need not pursue the point. Given the extremely limited review available on the merits, Weinstein's challenge to the comparative negligence allocation easily fails.

Weinstein has one other claim of error: that a finding of negligence required the panel to find that there was also a violation of the Florida blue-sky statute. But the arbitrators could have concluded that Florida law did not govern, or that negligence alone did not establish the additional elements of a blue-sky claim, such as reliance, *see E.F. Hutton & Co. v. Rousseff*, 537 So. 2d 978, 981 (Fla. 1989), or that the damages were no higher than $100. In the end, there is no basis for overturning the award.

Weinstein's final argument is an attack on arbitral provisions that steer securities disputes to panels allegedly friendly to brokers. Weinstein signed an agreement that provided for the arbitration that occurred, and he does not allege that he was deceived as to how the arbitration would be handled. Under these circumstances, it would take far more than rhetoric to support

an attack on the contract and nothing more is provided in this instance.

Affirmed.

* * *

BUFFALO LAW REVIEW

b. *Criticisms of the Manifest Disregard Standard.* Wrung out of ambiguous Supreme Court dictum, the manifest disregard standard has incited a rash of disapproval.* A self-defeating standard, it works only when arbitrators trumpet their mischief. Arbitrators are not obliged to explain their awards. The manifest disregard rule, along with prevalent arbitration practice, encourages, arbitrators into silence to avoid judicial contradiction. This tactic stymies even the modicum of accountability the test provides. A rule requiring arbitrators to explain their awards would not remedy this problem. Arbitrators who impose an idiosyncratic formulation of makeshift justice will surely be cunning enough to write an opinion concealing their transgressions.

Aside from being unworkable, manifest disregard fails as a standard of review because it does not achieve its objective. The purpose of the test is to provide some measure of review of substantive error in arbitration awards. As a means of correcting error, the standard might reasonably consider the magnitude, quality and consequence of the error under review, rather than the arbitrator's state of mind, a matter of irrelevance.

First, an appropriate standard of review might consider the error's *magnitude*, that is, how far the arbitrator strayed from governing law. Ignoring the law altogether evinces an error more serious than misinterpreting it.

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*All footnotes have been omitted.

When an arbitrator blunders in interpreting law, the magnitude of the mistake varies along a continuum. The most extreme errors reveal irrationality; such errors are wholly insupportable under any reasonable view of the law. A less flagrant error adopts an interpretation that is sensible though clearly incorrect under settled law. The most benign error adopts an arguable interpretation of unsettled law which the court ultimately rejects on review.

Second, the standard of review might reasonably take into account the *quality* of the error. If the arbitrator displaces governing law with an equally sensible alternative, the case for vacatur would be weak. If the arbitrator imposes an objectionable rule, the award is suspect.

Third, the standard of review might consider the *consequence* of the error. If the error denied victory to the party that should have prevailed under governing law, the court should vacate the award. Harmless error does not require vacatur.

The manifest disregard standard, as generally applied, considers neither the magnitude, the quality, nor the consequence of the error. Rather, the test fastens on the mental state of the arbitrator. If the arbitrator demonstrably knew the law and proceeded to ignore it, the court will vacate. What the arbitrator knew, however, should be immaterial. Review should concentrate on what the arbitrator did. By focusing on the arbitrators state of mind, the manifest disregard standard leads to a paradox. If the court somehow determines that an eminently sensible decision was based on a deliberate error the court will vacate the award. If the court determines

that a paroxysm of sheer stupidity afflicted the arbitrator at the moment of decision, the court will confirm.

One might criticize the test also for ignoring public policy. Any dispute, particularly one arising from statutory claims, may implicate matters of broad concern, eclipsing the interests of the parties. Intent on adjusting the rights of the parties to the dispute, arbitrators might fail to consider the effect of their decisions on those not represented at the proceedings. An erroneous decision might tacitly approve of violations of legal norms diluting their deterrent functions. Or worse, an error might perpetuate a continuing statutory violation harming a significant segment of the population. Unless an arbitrator, in the process of violating public policy, intentionally ignores controlling law, the manifest disregard standard will allow such an award to stand.

Most significantly, the manifest disregard test contradicts the implicit intent of the parties to submit to a more exacting standard of review. Since the essence of arbitration lies in contract, the agreement should govern. Though one may argue that the FAA provides the exclusive grounds for review, adoption of manifest disregard, a judicially-created standard, refutes the argument's practical effect. The overarching federal policy of arbitration calls for the enforcement of arbitration agreements as written. A manufactured standard of review, manifest disregard does not even consider the cornerstone of arbitration policy – the intent of the parties to the arbitration agreement.

* * *

NYSE ARBITRATOR HEARING TRANSCRIPTS

Re: Weinstein v. Fidelity Brokerage Services, Inc.

Date: December 3, 1996

Witness: Kurt Muller, Director of Trading, as called by Plaintiff

Page	Summary
5	Works for Fidelity Investment Advisor Group, FIAG; two years college at Northeastern University in Boston.
6	Not a ROP [Registered Options Principal].
6-7	No supervisory licenses.
8	Worked for Fidelity in other departments and joined FIAG April 1, 1994.
9-10	Director of the options trading desk to insure that orders are taken accurately from the investment advisors and delivered to the trading desk, etc. Now a Vice President.
11	Became Vice President only October 10, 1996. Has no compliance responsibilities. An employee with a Series 8 (supervision) works for him.
12	Re: X-2 (Fidelity's Answer). Answer claimed that all responsibility for suitability of investments rested with Classic and Lluria. (Long objection argument ensued.)
17	Muller says that "I'm not aware of any" rule putting the duty on Classic to determine suitability of the investments recommended to Weinstein. He also says that Fidelity is a discount broker and "discount brokers do not provide any recommendations or advice."

18	When asked if he knew of any industry rule or regulation providing for different treatment of discount firms from full service firms, he answered, "It's not my expertise, so I am not aware of that."
21	Acknowledges that Fidelity, in its Answer, did not assert that the Weinstein account was not speculative – I don't recall seeing that.
23	X-18, the Supervisory Procedures Compliance Manual.
24	He sees no place in the Compliance Manual that uses the word "discount."
28	Acknowledges that the introduction section reflects accurately FBSI's policy – that it will, at all times, operate in conformity with federal and state laws and regulations.[1]
29	The manual is accurate where it says that Fidelity will make employees aware of the various legal requirements.
31	Acknowledges that page 10 of X-18 says that nominal compliance is unacceptable. He also explains on 31 that "Compliance means making sure that all rules are followed under the different securities acts that there are and that they are following accordingly."
33	He has heard of NYSE Rule 405, and believes that it is the "know your customer rule."
34-35	Acknowledges that option applications must be filled in completely to show investment objectives, net worth, etc.

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[1] Account agreements also provide for adherence to securities laws, regulations and SRO rules. See Muller at 71.

38 He says "Yes, it is" when asked whether Fidelity's supervisory review ends upon review of the newly opened account (and before trading commences).

40-42 Basic position is that once the account is opened and the "level" [1, 2, etc.] of option trading is established, Fidelity's suitability obligation ends.

43-44 Says "Not that I am aware of" when asked if there were any procedures for monitoring the frequency or size of transactions as long as they were at the approved level [i.e., level 1, 2, etc.]. " . . . quantity doesn't come into play."

44 X-19 – the Supervisory Procedures and Compliance Manual that went into effect in 1993 at Fidelity.

45 X-19 refers to an option supervisory procedures manual, but he says "I am not aware of the options supervisory procedures manual."

48 X-20 – the third version of the supervisory procedures and compliance manual by FBSI.

52 Keith McDonald had compliance responsibilities with respect to Weinstein's account in 1994, his job was to supervise the account from a compliance perspective.[2]

53 But that only entails making sure that the correct level was checked on the application.

54 Since the trading desk automatically rejects anything beyond level 2 (for this account), he says that he is not aware of any other reason why you would need a procedures manual.

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[2] Mr. McDonald did not testify.

"Fidelity makes it pretty simple. The option level is on the account." "You don't have to refer back to the manual to handle trades."

56 X-21 re: opening new accounts.

57 Approved for level 2 "because you cannot have a margin account in an IRA account."

59-60 Dr. Weinstein was supposed to sign an LTA (Limited Trading Authorization). Has seen them for other customers, but not for Dr. Weinstein.

61 A full or LTA on file "would be marked on the system. . . . "

61 X-5.

66 X-3-4. Muller says that capital appreciation "to myself is maintaining an investment return on your money" (referring to the new account application).

68-69 X-4. The option account form. Comparing a blank form produced (X-4, at 8, Bates 140) it appears that capital appreciation is the only one indicated.

69 X-4. The options application shows Plaintiff with no prior experience trading commodities or options.

70 He explains the difference between capital appreciation and speculation as used on FBSI's forms. "Capital appreciation is investment income and maintaining principal. And speculation would be just what it is, speculation, risky."

71 X-3 (Bates 138) – paragraph 2 of the agreement itself provides that all transactions are subject to the rules, regulations, etc. This is also at X-4, at p. 10, Bates 142.

71-72 Identifying the statements.

74 X-8 – the first letter Muller wrote to Lluria, July 18, 1994.

75 Explains why the review took place – "Because our client, not only because of reasons of his trading history, but his assets for the firm had drastically reduced. And his original trading patterns were inconsistent with the trading patterns he first introduced at Fidelity."

76 Believes that the letter was prompted by [compliance supervisor] McDonald's review of the trades taken before the letter was sent. X-16 – the matched trading schedule.

77-78 Acknowledges very large August 445 S&P index positions for $325,000(?) [orders placed 6/30, $262,405, 7/13, $27,112 and 7/14, $42,210, total $331,727; see Ex. 15 at 42].

78 Acknowledges that the positions in the account were not consistent with an investment objective of capital appreciation: "Based on the original mix he brought to the group, that was inconsistent" and that could have prompted McDonald's review of the trading history.

79 Classic was the only investment advisor terminated by Fidelity since Mr. Muller was there. The decision was made by the group, Muller, McDonald and Jay Lanigan, Vice President of Client Services.

80 Lluria had perhaps 20 accounts at Fidelity.

81 There may have been 100 investment advisors working with FIAG at the time.

85 Muller probably talked to Eduardo Lluria two dozen times when he took trades. Block trades

were broken down. "So he might give us 500 contracts at one time, and then it's allocated to the clients' accounts."

86-87 Refers to Lluria as a client of the firm, but agrees that both Lluria and the investors were clients.

87 Muller says it's not his job to question Lluria about the size of the orders or "the activity that he is partaking in."

88 The meeting to terminate Classic/Lluria took place at 265 Franklin, in Lanigan's office.

89 Believes he was the one who called the meeting by bringing the trading to the attention of his bosses. The big trade in July [June 30, $262,405] for the August 445s probably triggered the event.

93 Explains that when a block order is taken "There is no review of the accounts every time a trade is placed to see what the concentration of any one security is in the account. That's just not their job responsibility."

94 Acknowledges that the account engaged in speculation when $236,000 [sic, $331,000] of puts were purchased in one month in an IRA account worth at the beginning of the month $310,000. "Yeah, that would be speculative."

When asked if an individual's account is reviewed to make sure that the activity is consistent with its investment objectives he answered " . . . it is not a responsibility of anyone on the trading desk to provide that information." When asked whose responsibility it was he says, "I'm not too sure."

95 Agrees that that size investment of $325,000 is not consistent with capital appreciation, but he is not sure that this precipitated the meeting. It wasn't noticed at the time the order was placed, but it was "obviously one of the reasons why we decided to discontinue, because there was not a balanced portfolio as what initiated – when he first came to the investment advisory group."

96 Acknowledges that the same option trades took place in the other accounts of Classic.

97 The concern was that the pattern of investing "was inconsistent with his original business."

98 Agrees that concentration increases risk.

99-100 Nobody at Fidelity contacted Weinstein or any other Classic customers to its knowledge. He did quantify the losses in all Classic accounts but does not recall the amount.

103 Doesn't believe any account lost $500,000 except Weinstein.

104 Agrees that this was "a big deal for our group." "Because it was the first time we ever had to disassociate ourselves from an investment advisor, end a relationship."

105 RE: X-12 – Lluria's "answer" re: his irrational decisions "which led me to lose so much money for my clients and myself."

105-106 He agrees that the investment decisions were irrational. "Based on the client's account type, I would say yes."

109-110 Acknowledges that there was no internal investigation conducted and reduced to writing concerning the Classic accounts.

110 Acknowledges that his concern about the business mix was "Out of concern for all of his clients, as well as for Fidelity." Also acknowledges that there was no need to go back prior to the current past month (June 1994) " . . . to see that he was solely trading options in the account."

112-113 X-11 – letter response to RD's request for monthly statements.

115 Microfiche missing.

116 Classic Asset Management is the only one asked to leave the FIAG group.

119 Agrees that Fidelity has not changed its pattern of supervision.

121-122 The actual system for taking an option order: the system monitors it for us so there is no additional review needed per trade.

122 Agrees that the system does no monitoring to see that the trading conforms to capital appreciation. He has to acknowledge that he does not know why investment objectives appear on the option application.

123 "It's background information." But he agrees that it's part of the firm's responsibility "to know its customer." Answer, "Yes, it is."

126 WOLENSKY: "I think at this point we don't have any questions of Mr. Muller during the Claimant's case in chief. And, if necessary, Mr. Muller will testify in the Respondent's case in chief."

127 There were no questions by the Panel.

Witness: John L. Lyman, Plaintiff's Expert on Damages

131 John Lyman resides in Clearwater, Florida, and did two years of college.

131-132 Worked for Merrill Lynch approximately three years and PaineWebber for two years.

133 Has worked on cases involving securities in arbitration – since 1990 when he left PaineWebber. Prepared a matched trading analysis of the account.

139-140 After leaving PaineWebber he worked for his brother's law firm analyzing arbitration claims.

147-148 The trading in foreign mutual funds resulted in a net gain of $66,000 but miscellaneous derivatives (as distinguished from U.S. options) have a net loss of $87,000. The S&P Index Puts (and one call) represented about 60 trades with a net loss of $464,400, representing a net out-of-pocket trading loss of $485,000.

151 There was one mutual fund, Robertson-Stephens Contrarian Fund in the account but sold June 2, 1994.

156 Arbitrator Bowker observes that the portfolio had a value of $103,000 at the end of May 1994 and at the end of June of $393,000. He asked for an explanation of how a portfolio could jump "from 103,000 on May 31 to 393 in June and back to 52,000 on July 31st, '94?"

160 Counsel explains that the option contracts move when the market moves.

160 ARBITRATOR SENESAC OBSERVES "THEY WANT TO GET RICH."

170 The net out-of-pocket losses came to $494,571.39.

171-173 Mr. Lyman enumerates the damages set forth in Exhibit 16, 1-2, based on different indices and legal interest.

174 Cross-Examination by Defendant.

179 When asked about the relevance of using the S&P 500 Index, Mr. Lyman indicates that large American companies would have been appropriate for a capital appreciation investment objective.

* * *

209 Denial of Defendant's Motion to Dismiss made at end of Plaintiff's case. The Chairman of the Panel announces the decision to deny Respondent's Motion to Dismiss the claim and asked that Respondent's put on their case.

210 [the next morning] Defendant rests without calling any witnesses. Counsel for Defendant announces that he has nothing to "add factually that is going to add to the knowledge that the panel has with respect t [sic] the true issues that are here." He offers Mr. Muller and James Bruckey (Fidelity's expert who sat through the prior day's testimony) to the panel for questioning should they so desire.

* * *

The Panel Questions to Mr. Kurt Muller

247 The Chairman asked whether there were "any discussion about contacting not only Mr. Lluria but also his clients?" To this Mr. Muller responded, "As I recall, there was not any conversation of contacting Mr. Weinstein."

250 Questions by counsel for Plaintiff.

253-254 When asked whether the change in the business mix from September 1992 to April 1994 was pretty drastic, Mr. Muller responded, "Foreign funds are speculative funds, and options are speculative funds in my mind."

254 The change in business mix was according to Mr. Muller, "Just a different style of securities. You have foreign funds and you have options. Both in my mind are speculative."

255 As of April '94 to July '94 – which led to the July 18th letter – you stated that "The options were totally in the account; that was the only thing [in the account]."